No. 91-1062

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

IVAN SCHATZ, *et al.*,
Petitioners,
v.
WEINBERG AND GREEN,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF IN OPPOSITION

BRENDAN V. SULLIVAN, JR.
JOHN G. KESTER *
MICHAEL S. SUNDERMEYER
NANCY F. PREISS
WILLIAMS & CONNOLLY
839 - 17th Street, N.W.
Washington, D.C. 20006
(202) 331-5000
Attorneys for Respondent

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Should § 10(b) of the Securities and Exchange Act of 1934 and SEC Rule 10b-5 be judicially extended to make attorneys liable for failure to disclose to an adverse party the financial condition of their own client, when the attorneys simply prepared closing documents, had no relationship of trust and confidence with the adverse party, and neither negotiated, solicited, nor made any representation whatsoever concerning the transaction?

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BRIEF IN OPPOSITION

OPINIONS BELOW

The opinions of the United States Magistrate (Pet. App. 51) and of the District Court (Pet. App. 136) are unreported. The opinion of the Court of Appeals is reported at 943 F.2d 485 (Pet. App. 1).

JURISDICTION

The judgment of the Court of Appeals was entered August 26, 1991. A petition for rehearing was denied October 1, 1991. The petition for a writ of certiorari was filed December 30, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254.

STATEMENT

Petitioners, sellers of stock in two businesses, sued the guarantor of the purchaser's notes, claiming that the guarantor had misrepresented his worsening financial situation that led to his ultimate bankruptcy and inability to pay the notes. In addition, petitioners sued respondent, the law firm the guarantor retained after the sale had been negotiated to prepare the closing documents.

No allegation was made that respondent had prepared any financial statements for its clients; that it had prepared any solicitations; that it had participated in the negotiations leading to the sale; that it had offered any false or misleading opinion letter; or that it had made any representation whatsoever to petitioners. What was alleged was that respondent had been silent about its client's financial condition; and that respondent as the guarantor's attorneys had drafted the closing documents, and then delivered them along with a letter from the guarantor concerning his financial condition for review to petitioners' counsel, the Washington, D.C. law firm of Arent, Fox, Kintner, Plotkin & Kahn.

Petitioners filed three successive complaints. The first, which they first filed in the United States Bankruptcy Court for Maryland and then were allowed to transfer to the United States District Court, in addition to various claims against the client, charged respondent simply with misrepresentation under Maryland law. When respondent moved to dismiss under Rule 12(b)(6), Fed. R. Civ. P., for failure to state a claim, petitioner then filed an amended complaint, which added a charge that respondent had aided and abetted alleged violations by the client of § 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10 5b, and § 12 of the Securities Act of 1933, 15 U.S.C. § 77*l*. After respondent again moved to dismiss, petitioners filed yet another amended complaint, adding a claim that respondent itself by failing to disclose its

client's financial situation had violated § 10(b) and Rule 10b-5. Respondent for the third time moved to dismiss.

On reference from the District Judge, a United States Magistrate recommended that the latest complaint be dismissed as to respondent for failure to state a claim on which relief could be granted. Pet. App. 51. The District Judge (Howard, J.) on *de novo* review agreed, noting agreement with the Magistrate's observation that "[n]owhere, in the many pages of opposition, do plaintiffs even hint at what Weinberg & Green did to cause Rosenberg [the guarantor] to commit fraud." Pet. App. 151. The District Court pointed out that the alleged violation of § 10(b) was based on nondisclosure, rather than any misrepresentation by respondent. The Court relied on this Court's holding in *Chiarella* v. *United States*, 445 U.S. 222 (1980), that "when an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak." 445 U.S. at 235. Pet. App. 150.

The United States Court of Appeals for the Fourth Circuit (Wilkinson, Chapman and Hilton, JJ.) affirmed. Relying as had the District Court on this Court's decision in *Chiarella* v. *United States*, *supra*, as well as *Dirks* v. *SEC*, 463 U.S. 646 (1983), and similar holdings of the Fifth and Seventh Circuits, the Court of Appeals held that under § 10(b) of the Securities and Exchange Act, any duty to disclose must arise from the relationship of the parties, and does not exist unless there is "a fiduciary or other similar relation of trust and confidence." Pet. App. 14, quoting *Chiarella* v. *United States*, *supra*, 445 U.S. at 228. It explained that the law was well established that "a lawyer or law firm cannot be held liable for misrepresentation under section 10(b) for failing to disclose information about a client to a third party absent some fiduciary or other confidential relationship with the third party." Pet. App. 15. An attorney could be liable for making a false representation, the Court added, but none was alleged here. Pet. App. 32.

The Court of Appeals also affirmed dismissal of the aiding-and-abetting claim, citing many cases holding that such liability requires an allegation of "high conscious intent" and "conscious and specific motivation" to defraud. Pet. App. 41. The Court of Appeals also agreed with the District Court that Maryland law, like the federal securities laws, imposes no affirmative duty to disclose absent a relationship of trust. With respect to "public policy" arguments made by petitioners for extending nondisclosure liability to the opposite party's attorneys, the Court of Appeals observed that there were powerful reasons of policy for leaving the law as it is. Pet. App. 27-31.

REASONS FOR DENYING THE WRIT

The Court of Appeals here, affirming the District Court, simply followed an unbroken line of decisions of this Court and of other courts of appeals. There are no decisions in conflict. Moreover, the existing law reflects sound policy which, even if it were to be changed, should be changed by the Congress, and not by the courts.

I. THERE IS NO CONFLICT WITH ANY DECISION CONSTRUING § 10(b).

A. The Court of Appeals Followed the Decisions of this Court.

The Court of Appeals decided nothing new. It simply applied the holding of this Court in *Chiarella* v. *United States*, 445 U.S. 222 (1980), that

> "Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud. When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak."

445 U.S. at 234-35. "[S]ilence in connection with the purchase or sale of securities may operate as a fraud actionable under § 10(b) . . . . But such liability is premised upon a duty to disclose arising from a relationship of

trust and confidence between parties to a transaction." *Id.* at 230. *Accord, Dirks* v. *SEC*, 463 U.S. 646, 657-58 (1983). That is precisely what the Court of Appeals held here. Pet. App. 15, 22-23.

B. There Is No Conflict in the Circuits.

Petitioners assert a conflict with two decisions of other courts of appeals. Those decisions are not even remotely in conflict with the Court of Appeals' ruling here.

Ikuno v. *Yip*, 912 F.2d 306 (9th Cir. 1990), the first case relied on by petitioners, arose under a wholly different statute, the Racketeer Influenced and Corrupt Organizations (RICO) Act, 18 U.S.C. § 1964. The court there held that summary judgment was inappropriate where there was a factual issue as to whether the defendant attorney had gone beyond legal representation, and had in fact also personally controlled the corporation accused of a fraudulent scheme.

Breard v. *Sachnoff & Weaver, Ltd.*, 941 F.2d 142 (2d Cir. 1991), did involve § 10(b) and Rule 10b-5. But in *Breard* the defendant attorneys had not simply prepared closing documents. They had gone beyond that and actually drafted solicitations that contained misrepresentations, intending that these be shown to prospective limited partners of the partnership they represented. In the present case, by contrast, "Weinberg and Green did not solicit any purchase of securities or prepare any solicitation documents. In fact, Rosenberg [the guarantor] and the Schatzes [the petitioners] worked out the details of the purchase of the business before involving the attorneys for either side." Pet. App. 22. Moreover, petitioners, unlike the solicited limited partners in *Breard*, did not even attempt to claim that the legal services performed by respondent were for their benefit, and thus that some duty was owed to them by respondent.

What the courts of appeals really have to say about the kind of new liability petitioners seek to create has

been very clear and very uniform. The Fourth Circuit is simply the latest in an unbroken line.

For example, the Seventh Circuit has held that when the claim is not one of misrepresentation, but rather of a "failure to 'blow the whistle,' " there is no liability under § 10(b) unless the defendant had "a *duty* to blow the whistle." *Barker* v. *Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 496 (7th Cir. 1986) (emphasis in original). It added that "[n]either lawyers nor accountants are required to tattle on their clients in the absence of some duty to disclose. . . . To the contrary, attorneys have privileges not to disclose." 797 F.2d at 497.

In another case on which the Court of Appeals here relied, the Fifth Circuit likewise held that an underwriter's counsel owed bondholders no duty under the securities laws to disclose inaccuracies in an offering statement for the bonds. "An attorney required by law to disclose 'material facts' to third parties might thus breach his or her duty, required by good ethical standards, to keep attorney-client confidences. Similarly, an attorney required to declare publicly his or her legal opinion of a client's actions and statements may find it impossible to remain as loyal to the client as legal ethics properly require." *Abell* v. *Potomac Ins. Co.*, 858 F.2d 1104, 1124 (5th Cir. 1988), *vacated on other grounds*, 492 U.S. 914 (1989) (footnote omitted).

Similarly, there are many court of appeals holdings that accountants have no duty under the federal securities laws to disclose their clients' financial information. *E.g.*, *DiLeo* v. *Ernst & Young*, 901 F.2d 624 (7th Cir.), *cert. denied*, 111 S. Ct. 347 (1990); *Latigo Ventures* v. *Laventhol & Horwath*, 876 F.2d 1322, 1327 (7th Cir. 1989) ("It is not the law that whenever an accountant discovers that his client is in financial trouble he must blow the whistle on the client for the protection of investors"); *Windon Third Oil and Gas Drilling Partnership* v. *FDIC*, 805 F.2d 342, 347 (10th Cir. 1986) (absent

fiduciary or other relationship of trust and confidence, accountant had no duty to disclose information about corporation's financial condition during discussions with potential investor), *cert. denied,* 480 U.S. 947 (1987).

C. No District Court Decisions Are in Conflict.

Petitioners also assert a conflict with three reported and two unreported decisions of federal district courts.[1] That, of course, would not be a reason for granting certiorari. See Supreme Court Rule 10. But even these decisions are in no wise inconsistent with the ruling in this case. No one disputes the general proposition that attorneys can be "liable to third parties for fraud." Pet. 6. No one suggests some sort of immunity. But, what matters here, no case has ever held that mere silence by an attorney who takes no part in the solicitation or negotiation of a securities transaction violates federal law. The district court cases that petitioners cite all involved attorneys who did more, as by preparing misleading opinion letters or solicitation documents to be given to investors.

II. NO DECISION CONFLICTS WITH THE HOLDING THAT AIDING AND ABETTING HAD NOT BEEN PLEADED.

With respect to aiding and abetting, the Court of Appeals simply held that the claim had not been adequately pleaded in petitioners' second amended complaint.

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[1] *In re Flight Transportation Corporations Securities Litigation,* 593 F. Supp. 612 (D. Minn. 1984); *Ahern* v. *Gaussoin,* 611 F. Supp. 1465 (D. Ore. 1985); *Rose* v. *Arkansas Valley Environmental and Utility Authority,* 562 F. Supp. 1180 (W.D. Mo. 1983); *Boltz* v. *Flagship Partners Limited Partnership,* unreported, No. 89 C 9103 (N.D. Ill. Aug. 22, 1990); *In re ZZZZ Best Securities Litigation,* unreported, No. CV 87-3574 RSWL (C.D. Cal. July 23, 1990).

Applying well settled law, it held that where as here the sum total of the allegations against an attorney were that the attorney "knowingly and/or recklessly provided substantial assistance" to the fraud, such an allegation did not meet the requisite "high conscious intent" and "conscious and specific motivation" to aid the fraud, the standard required by numerous appellate and district courts in those circumstances where, as here, no duty was owed by the alleged aider and abettor to the plaintiff. Pet. App. 41; *see, e.g.*, *IIT* v. *Cornfeld*, 619 F.2d 909, 925 (2d Cir. 1980); *Woodward* v. *Metro Bank*, 522 F.2d 84, 97 (5th Cir. 1975); see also *Bloor* v. *Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 57, 62 (2d Cir. 1985). When an attorney's actions constitute no more than "the daily grist of the mill," there is no liability for aiding and abetting in the absence of an allegation that petitioners' second amended complaint notably lacked—that of a clear intention to violate the securities laws. *Woodward* v. *Metro Bank*, *supra*, 522 F.2d at 97.

The Court of Appeals here accordingly held that to be liable for aiding and abetting, a defendant must have rendered substantial assistance to the primary securities law violation itself, and not simply to the person alleged to have committed the violation. Pet. App. 45. Because, according to petitioners' allegations, respondent merely reduced to writing the terms of a deal that had already been negotiated by the principals, committed no misrepresentations, and did not vouch for the accuracy of its clients' representations, which were given to petitioners' sophisticated counsel, the court below correctly held that its participation did not rise to the level of "substantial assistance." Pet. App. 46-47. Petitioners cannot, and do not, claim that the Court of Appeals' decision conflicts in this respect with any decision of any other court of appeals or, indeed, with any decision of any court anywhere.

III. THE SECURITIES LAWS DO NOT REQUIRE REVISION BY THIS COURT.

Petitioners assert that the Court of Appeals' decision immunizes attorneys from liability for fraud. Pet. 6, 11. But it does nothing of the kind. As the opinion makes clear, attorneys are no more immune from liability than anyone else—nor should they be—if they make an affirmative misrepresentation, if they fail to disclose what they have a duty to disclose to a person in a relationship of trust or confidence, or if they render intentional and substantial assistance to a wrongful act. All that the Court of Appeals did was to reaffirm a well-established legal standard. The Magistrate, the District Court, and the Court of Appeals concluded that petitioners' allegations, when measured against that clear legal standard, did not state a claim for violation of § 10(b) of the Securities and Exchange Act or SEC Rule 10b-5, or for aiding and abetting one.

Petitioners' argument, as they have recognized,[2] really is one of policy: that liability under the law should be expanded and extended to make attorneys liable for nondisclosure to an adverse party with whom they have no relationship of trust, when they neither engage in nor assist in negotiation or solicitation, and make no representation whatsoever. Perhaps an argument can be made that the law should be changed sometime to permit new lawsuits of this type. But the Court of Appeals pointed out that the policy considerations are by no means all on one side:

> "Attorney liability to third parties should not be expanded beyond liability for conflicts of interest. . . . Any other result may prevent a client from reposing complete trust in his lawyer for fear that he might

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[2] Petitioners argued, *inter alia*, that "this Court need look no further than basic public policy in finding a duty to disclose. We cannot live in a society which gives lawyers the right to assist in carrying out a fraud." Brief for Appellant, Fourth Circuit, at 31.

reveal a fact which would trigger the lawyer's duty to the third party. Similarly, if attorneys had a duty to disclose information to third parties, attorneys would have an incentive not to press clients for information. The net result would not be less securities fraud. Instead, attorneys would more often be unwitting accomplices to the fraud as a result of being kept in the dark by their clients or by their own reluctance to obtain information." Pet. App. 28-29.[3]

Most importantly, even if one concluded that petitioners were wholly correct as to what provisions would make ideal securities laws, and all the courts were wrong, such a change in the substantive scope of liability under the securities laws is more appropriately left to the Congress. "Formulation of such a broad duty, which departs radically from the doctrine that duty arises from a specific relationship between two parties, . . . should not be undertaken absent some explicit evidence of congressional intent." *Chiarella* v. *United States*, *supra*, 445 U.S. at 233; *cf.* also, *e.g.*, *INS* v. *Elias Zacarias*, 112 S. Ct. 812 (1992); *TVA* v. *Hill*, 437 U.S. 153, 194-95 (1978).[4]

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[3] As the Seventh Circuit similarly observed, in the parallel context of accountants:

> "Such a duty would prevent the client from reposing in the accountant the trust that is essential to an accurate audit. Firms would withhold documents, allow auditors to see but not copy, and otherwise emulate the CIA, if they feared that access might lead to destructive disclosure—for even an honest firm may fear that one of its accountant's many auditors would misunderstand the situation and ring the tocsin needlessly, with great loss to the firm."

DiLeo v. *Ernst & Young*, 901 F.2d 624, 629 (7th Cir.), *cert. denied*, 111 S. Ct. 347 (1990), quoted by the Court of Appeals at Pet. App. 30. Moreover, "[l]aw firms and accountants may act or remain silent for good reasons as well as bad ones . . . ." *Barker* v. *Henderson, Franklin, Starnes & Holt*, *supra*, 797 F.2d at 497.

[4] In particular, this Court has consistently rejected attempts, even by the Securities and Exchange Commission, to extend the scope of § 10(b) of the Securities and Exchange Act. See, *e.g.*, *Dirks* v. *SEC*, *supra*; *Santa Fe Industries, Inc.* v. *Green*, 430 U.S.

CONCLUSION

For the reasons stated, certiorari should be denied.

Respectfully submitted,

BRENDAN V. SULLIVAN, JR.
JOHN G. KESTER *
MICHAEL S. SUNDERMEYER
NANCY F. PREISS
WILLIAMS & CONNOLLY
839 - 17th Street, N.W.
Washington, D.C. 20006
(202) 331-5000
Attorneys for Respondent

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* Counsel of Record

462, 471-73 (1977); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 214 (1976).